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THE "CHANGE OF BENEFICIARY" CLAUSE IN LIFE INSURANCE POLICIES.

THE proceeds of a policy of life insurance payable to the estate of the insured pass, on his death, to his personal representative, and are assets for the payment of his debts. Likewise, the cash surrender value of a policy so payable may be subjected, during the lifetime of the insured, by his creditors, and, in the event of his bankruptcy, it may be collected by his trustee in bankruptcy as an asset of the estate.

But if the policy be payable to another person named as beneficiary therein, the proceeds, on the death of the insured, pass absolutely to the beneficiary and are not subject to the demands of the creditors of the insured. The cash surrender value also belongs to the beneficiary, and cannot be realized by the insured, nor claimed by his creditors. The beneficiary's interest in such a policy becomes vested at the time of the issuance of the policy, and the insured has no control thereafter over it or its surrender value, except, of course, that he may discontinue the payment of the premiums thereon, thereby causing the policy to lapse.

The advantage of making a policy of life insurance payable to one's estate is that the ownership of the policy remains in the insured; he has absolute dominion over it and can collect the cash surrender value thereof if he so desires, or he may borrow money on it as collateral security. The disadvantage is that the value of the policy, like any other property, is subject to the claims of his creditors, and dependent members of his family may thereby lose the benefit of the insurance caused by his own improvidence or misfortune.

The advantage of making the policy payable to a named beneficiary is that in this way the policy is placed absolutely beyond the power of the insured, and also beyond the reach of his creditors and vests absolutely in the beneficiary. The disadvantage is that the insured cannot thereafter make any use of the policy, or any change in the object of his bounty unless the beneficiary consents thereto.

Within comparatively recent years an ingenious attempt has been made "to happily combine the advantages of both," and a plan has been adopted by most, if not all, of the life insurance companies in this country designed to enable one "to eat his cake and have it too." This plan finds expression in the "change of beneficiary" clause, which gives to the insured, holding a policy of insurance payable to a named beneficiary, the right to change the beneficiary at any time without the necessity of obtaining the consent of the beneficiary.

Aside from the legal questions involved, which will be discussed presently, the views of the insurance authorities are variant as to the wisdom of such a provision. Of course such a clause in the policy is of great convenience to the insured. He is enabled thereby to borrow money on the policy as collateral security; or, if so disposed, he may surrender the policy and collect from the insurance company in cash its surrender value; or, in the event family troubles make it desirable, he can make a change in the beneficiary without the consent, or even the knowledge, of the beneficiary. Those are unquestionably strong considerations in favor of this clause from the standpoint of the insured. But after all, does not this clause set at naught the chief object of life insurance, namely, protection for those dependent?

Let us now consider briefly the legal effect of this clause giving the insured power to change the beneficiary. Does it accomplish what it was intended to do? Does it "happily combine" the advantage of a policy made payable to one's estate, namely, absolute control of the insured, with the advantage of a policy made payable to a named beneficiary, namely, immunity from the claims of creditors of the insured? Undoubtedly, the first advantage is secured—the insured has absolute control of the policy; but there is serious doubt if the second advantage has been secured. In fact, it would seem that in this instance ingenuity had over-reached itself, and that by giving to the insured absolute control over the policy it has thereby become his property, and its value liable to the claims of his creditors.

On principle it seems clear that if the insured has the power, without the consent of the beneficiary, to erase her name as

beneficiary and substitute his own instead, and then hypothecate the policy with a bank as collateral security for a loan made to him, or obtain from the company its cash value,—he has some substantial property interest in that policy which should, in justice and in law, be subject to the claims of his creditors.

We will now consider some of the decisions of the courts on the subject of the legal effect of the "change of beneficiary" clause.

In the case of *In Re* Herr [1] a rule was issued against the bankrupt to show cause why he should not pay or secure to his trustee the cash surrender value of a policy of life insurance. The policy, which was payable to his wife in the event of his death before a certain date, contained a provision giving him the right to change the beneficiary. It was held that the trustee was entitled to the surrender value of the policy. To the same effect is *In Re* Dolan.[2]

In the case of *Re* Orear [3] the trustee of the bankrupt filed a petition before the referee asking that certain policies of insurance on the life of the bankrupt be turned over to him as assets of the estate. The referee ordered delivery of the policies, but the district court reversed this ruling and an appeal was taken to the Circuit Court of Appeals. Some of the policies were payable to members of the bankrupt's family as beneficiaries, but at the time of the filing of the petition in bankruptcy none of these policies had any surrender value. It was held by the Circuit Court of Appeals that in view of the provision allowing the change of beneficiary, the bankrupt was the real owner of the policies and they passed to his trustee as assets.

This case, in so far as it holds that the policies of insurance were assets of the bankrupt's estate, notwithstanding they had no surrender value at the time of the filing of the petition, has, of course, been overruled by the case of Burlingham *v.* Crouse [4] and other cases decided about the same time, but the question which we are now discussing is not affected by those decisions.

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[1] 182 Fed. 716.
[2] 182 Fed. 949.
[3] 178 Fed. 632, 30 L. R. A. (N. S.) 990.
[4] 228 U. S. 459.

The policies in those cases were payable to the estate of the insured or to his personal representative.

While this question has arisen more frequently in bankruptcy cases than in any others, its consideration has not been confined to those cases. For instance, in the case of Littleton *v.* Sain [5] a bill in chancery was filed against a widow to subject the proceeds of an accident insurance policy to the payment of a debt with which she had while married charged her separate estate. The policy was issued by a fraternal order to her husband and was payable to her, but he had the right to change the beneficiary at any time. As a matter of fact, he did not exercise this right, and at his death, due to an accident, the money was paid over to her. The question was whether she acquired a vested interest in the policy before the death of her husband; if so, it constituted part of her separate estate and was charged with the payment of the debt in question. But if she did not acquire a vested interest in the policy before the death of her husband, then on his death it became a general and not a separate estate in her. It was held by the Supreme Court of Tennessee that she did not acquire a vested interest in this policy of insurance during her husband's lifetime.

In the case of Equitable Life Assurance Company *v.* Stough [6] it appeared that the policy of insurance was issued to the insured payable to his mother, but with the right reserved to change the beneficiary. Before the first premium had been fully paid he voluntarily surrendered the policy to the company's agent and received back his note given for a portion of the first premium. Shortly thereafter he died, and his mother brought suit on the policy as beneficiary. Recovery was denied on the ground that she had no vested interest in the policy. Says the court:

> "Where insured in a life policy has the right under the policy to change the beneficiary, the latter has no vested interest, but the insured's control of the property is complete."

These cases—and many others could be cited to the same effect—constitute strong authority in support of the proposition

[5] 126 Tenn. 461, 150 S. W. 423, 41 L. R. A. (N. S.) 1118.

[6] 45 Ind. A. 411, 89 N. E. 612.

that the beneficiary, in a policy of insurance where the right to change the beneficiary is reserved, takes no vested interest in the policy, but that the same is subject to the control of the insured, and its value is liable to be subjected by his creditors for the payment of their claims.

But there are other well-considered cases which take a different view of this question. These cases hold that the beneficiary takes a vested interest in the policy at the time of its issuance, and that the reserved right to change the beneficiary is simply a power which may or may not be exercised by the insured, that it can be exercised by him and by no one else, and that unless and until this power is exercised by the insured the beneficiary's interest in the policy is not affected.

In National Bank of Commerce *v.* Appel Clothing Company[7] a creditor's bill was brought by the plaintiff to subject to the payment of its claims the surrender value of certain life insurance policies taken out on the lives of its debtors. The policies provided for the payment of certain sums of money to the insured at the end of certain specified periods, but in the event of their death before the expiration of said periods, then payment was to be made to members of their families. Under these policies the insured had full authority to change the beneficiaries without their consent. It was decided that the court had no authority to subject these policies; that "the beneficiaries cannot be divested of their interests except by acts of the insured."

In the case of McCutchen *v.* Townsend,[8] it appeared that the policy of insurance contained no clause giving the insured the right to change the beneficiary, but there was a provision giving him the right at certain specified periods to apply for and receive the cash surrender value. It was held that no interest in this policy passed under a general deed of assignment executed by the insured because his interest therein was "remotely contingent, and incapable of being valued."

Another important case, which seems to have been generally overlooked in the consideration of this question, is that of Jones

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[7] 35 Col. 74, 83 Pac. 965, 4 L. R. A. (N. S.) 456.

[8] 127 Ky. 230, 105 S. W. 937, 16 L. R. A. (N. S.) 316.

v. Clifton,[9] decided by the Supreme Court of the United States on March 2nd, 1880. A man by the name of Clifton conveyed by deed certain property, including five policies of life insurance, to his wife, reserving in the deed the power to revoke the grant, in whole or in part, and to transfer the property to any other use, and to such other person as he might designate. Some time thereafter he was adjudged a bankrupt, and his assignee in bankruptcy made claim to this property, including the policies of insurance, his claim being based on the ground that the deed was void because of the reservation which gave the grantor the control and enjoyment of the property. It was claimed that the power of revocation and appointment reserved in the deed were assets which passed to the assignee in bankruptcy and could be executed by him for the benefit of creditors. This contention, however, was not sustained by the court. Says Mr. Justice Field:

> "The powers of revocation and appointment to other uses reserved to the husband in the deeds in question, do not impair their validity or their efficiency in transferring the estate to the wife, to be held by her until such revocation or appointment be made."

Again:

> "The title to the land and policies passed by the deeds; a power only was reserved. That power is not an interest in the property which can be transferred to another, or sold on execution, or devised by will. The grantor could, indeed, exercise the power either by deed or will, but he could not vest the power in any other person to be thus executed. Nor is the power a chose in action. It did not, therefore, in our judgment, constitute assets of the bankrupt which passed to his assignee."

This case was followed in Brandies *v.* Cochrane.[10] The Virginia case of Freeman *v.* Butters [11] throws light on this phase of the question.

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[9] 101 U. S. 225.

[10] 112 U. S. 344.

[11] 94 Va. 406, 26 S. E. 845.

To what extent the case of Jones *v.* Clifton is controlling of the question now under discussion is not altogether clear. In the examination of the cases on this precise question we have found no reference made to that case. Perhaps an out-and-out assignment, as was made in that case, is more effective to vest title in the assignee to insurance policies payable to the estate of the assignor, than is the mere naming of a person as beneficiary in the first instance, coupled with the power to change the beneficiary. This may be the distinguishing feature between Jones *v.* Clifton and the cases above cited in support of the other view, which would render the doctrine of that case inapplicable. But even if this be true, the insured could invoke the protection of that doctrine and accomplish the same result by taking out the policy in the first instance payable to his estate, and then assign it to the chosen beneficiary, reserving in the body of the assignment the power of revocation and appointment to other uses. It would seem, under the doctrine of Jones *v.* Clifton, that such a method would be efficacious and would protect the beneficiary against the claims of the creditors of the insured, and at the same time give to the latter virtual control over the policy.

On account of the variant views entertained by the courts on this question, it is, of course, impossible to state with any degree of confidence what the true doctrine is. In so far as bankruptcy cases are concerned we must await an authoritative decision of the Supreme Court of the United States. Where the question arises in cases other than bankruptcy probably such a decision would be followed by the courts of last resort of the various states which have not already passed upon the question. But on principle we adhere to the view already expressed, that inasmuch as this change of beneficiary clause gives the insured complete control over, and the beneficial ownership of the policy, it must be considered in law his property and subject to the claims of his creditors.

Some of the states have laws protecting the beneficiary in a policy of insurance containing such a reservation from the claims of creditors of the insured. The legislature of Ohio has recently passed such a law. But in the absence of such legislation, one who really desires to provide effectively for those de-

pendent on him, and to avoid the risk of his own improvidence or misfortune, will best serve their interest by having eliminated from his policy the "change of beneficiary" clause.

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In this connection—although not strictly germane to the subject of this article—it may be well to consider what is the property interest in an insurance policy which may be reached by creditors of the insured, assuming that it is subject to their claims. This inquiry is pertinent not only in the cases which we have been considering where the policy provides for a change of the beneficiary, but also in cases where the policy is made payable to the estate of the insured and his creditors lay claim to it.

In bankruptcy cases this question has been definitely decided by the Supreme Court of the United States in the recent cases of Burlingham *v.* Crouse,[12] Everett *v.* Judson,[13] and Andrews *v.* Partridge.[14] In these cases it was decided that the trustee in bankruptcy was entitled to receive as assets of the estate of the bankrupt the cash surrender value of policies of insurance on his life as of the time of filing the petition in bankruptcy. If at this time the insurance policies had no surrender value, then the trustee in bankruptcy would take nothing under the policies, notwithstanding the bankrupt might die before he was actually adjudged a bankrupt, in which event the face of the policies would become payable.

It is probable that when this question arises in cases other than bankruptcy—for example, in a creditor's suit, or an attachment suit brought against the insured—this ruling of the Supreme Court of the United States defining the property interest in a policy of life insurance will be followed. In thus limiting the creditor's rights, and in determining this property interest, the court was announcing a principle of universal law applicable alike to bankruptcy cases and all other cases where it might become necesssary to subject this interest. Mr. Justice Day puts it this way:

[12] 228 U. S. 459.
[13] 228 U. S. 474.
[14] 228 U. S. 479.

"We think it was the purpose of Congress to pass to the trustee that sum which was available to the bankrupt at the time of bankruptcy as a cash asset."

It would seem clear that in any case where a creditor is seeking to subject to his demands the value of a policy of insurance held by his debtor, he should be limited to the sum "which was available" to the debtor at the time of the proceeding "as a cash asset."

If then the creditor can subject for the satisfaction of his claim only the cash surrender value of his debtor's insurance policy, what is this so-called cash surrender value, and how is it ascertained?

That amount—with the interest accumulations thereon—which the company has been reserving out of the premiums to take care of the future risk is the real cash value of the policy at any particular time. But it does not necessarily follow that this is the amount which the company would be willing to, or should, pay to the insured on the surrender of his policy. Many things are to be taken into consideration which materially affect this, but which it is not pertinent to discuss in this connection.

Some of the insurance companies issue policies which distinctly state what the cash surrender value of the policy shall be at any particular time. The policies of other companies do not contain this feature, but the surrender value at any particular time is ascertained by some method of computation and paid to the insured. In the case of Hiscock *v.* Mertens [15] it was held that "cash surrender value" as used in the National Bankruptcy Act embraced the values specified in the policies, or the values which the companies recognized by practice or concession, although they might not be under any contractual obligation to pay such values.

Such then is the basis of the "cash surrender value." It is the extent of the property interest which the insured has in his policy, and generally speaking it is all that may be subjected by his creditors, unless, of course, the policy is payable to his estate

[15] 205 U. S. 202.

and he dies indebted, in which event the entire proceeds of the policy would be assets in the hands of his personal representative for the payment of his debts.

The writer has not attempted to refer to all of the cases on the subject of this article, but has contented himself with making reference to those on each side of the question which are most pertinent.

E. R. F. Wells.

NORFOLK, VIRGINIA.